No. 1371.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

HERBERT STRAIN,

Appellant,

vs.

H. B. PALMER, Receiver, BENJAMIN GRAHAM, Trustee, THE AMERICAN FREEHOLD LAND MORTGAGE COMPANY OF London, England, Limited, H. H. NELSON SHEEP COMPANY, H. H. NELSON and JAMES T. STANFORD,

Appellees.

BRIEF FOR APPELLEES.

M. S. GUNN,
Attorney for Appellees.

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Order Appealed From.

The petition by which the appellant asserted a claim to the hay and oats was denied by an order entered on the 26th day of February, 1906. (Record, p. 66.) Afterwards, and on the 5th day of May, 1906, appellant filed objections to the final report and account of the receiver. (Rec., p. 72.) In the objections filed it is stated that the same are

> "based upon the fact, as shown in the said receiver's report, that at the sale of the said real estate, in pursuance of the decree of this court, the complainants herein purchased all of said real estate for a sum sufficient to cover their mortgage indebtedness, in-

> terest and costs, so that the said mortgage thereby became satisfied in full, without recourse to the said hay and oats, which had theretofore, to-wit, on the 17th day of August, 1904, been purchased by the undersigned, as fully appears from his petition and the agreed statement of facts on file herein." (Rec., p. 73.)

The objections were overruled by an order dated the 28th day of May, 1906. (Rec., p. 75.) This order was amended on the 31st day of May, 1906. The amendment provides:

> "That the petition *pro inter esse suo* of Herbert Strain in this suit be and is hereby denied and refused, and that the proceeding by way of said petition be, and is hereby finally dismissed." (Rec., p. 75.)

The appeal is from the order dated May 28, 1906, and the amendment thereto. The order dated Feb. 26, 1906, denying the petition, is not appealed from.

In view of these conditions it is submitted that this court can not review the decision of the circuit court denying the petition. The order dated Feb. 26, 1906, is clearly a final order from which an appeal might have been taken. This order finally disposed of the claim as presented by the petition, and the subsequent order dated May 31st is of no consequence. The only matter to be considered by this court is the correctness of the decision of the circuit court in overruling the objections to the final report and account of the receiver.

Objections to Report and Account of Receiver Properly Overruled

It will be noticed that these objections do not controvert the fact that the receiver has accounted for all property received by him, or in any manner question the report or a single item of the account, but are based solely upon the proposition that the property described in the mortgage or trust deed was sold for an amount sufficient

to pay the mortgage indebtedness and costs. In other words, appellant took the position that the receiver should be required to turn over to him the hay and oats, or the proceeds thereof, notwithstanding the expenditures made by the receiver, his claim for compensation, and a reasonable compensation to be paid his solicitor, were largely in excess of his receipts.

The circuit court, in denying the claim of appellant to the hay and oats, had decided that the receiver was properly appointed and was entitled to the possession of such hay and oats. This being true, the receiver was entitled to credit for his expenditures properly made, to an allowance for his solicitor, and to payment of his claim for compensation, notwithstanding it developed after his appointment that the property was of sufficient value to pay the mortgage indebtedness and costs. Any other rule would subject the receiver to a danger of liability and loss which would deter anyone from accepting an appointment to such office. It is alleged in the bill of complaint that the property described in the trust deed is insufficient security for the payment of the indebtedness, and that the parties liable for such indebtedness are insolvent. These allegations justified the appointment of a receiver of the rents and profits. The fact that the property may have increased in value between the date of the filing of the bill and the sale, or the fact that the complainants may have been mistaken in their judgment of the value of the property, does not determine that the appointment was invalid. If the appointment was valid and authorized, as it certainly was, the complainants can not be held liable to the receiver for his expenses or compensation, but he is required to resort to the property or fund for payment.

Ferguson v. Dent, 46 Fed. Rep. 88.

Elk Fork Oil Co. v. Foster, 99 Fed. Rep. 495, 499.
Alderson on Receivers, p. 860.

In the opinion in the first case cited the court said:

"When it becomes the duty of a court of equity to take property under its own charge through a receiver, the property becomes chargeable with the necessary expenses incurred in taking care of and saving it, including the allowance to the receiver for his services. Such is unquestionably the well-settled law, and a citation of authorities in support of it would seem to be needless. No case to the contrary has been cited by counsel, nor any in support of their position, except those heretofore noticed; and it is believed that not one decision can be found holding that the proper expenses of a receiver, or his compensation shall be taxed as costs against the losing party, where his appointment was proper and legal, and made by a court in the exercise of its undoubted jurisdiction, and where the fund in his hands is sufficient to pay the same. Nor does the legality or propriety of his appointment depend at all upon the event of the suit. Because it is ultimately determined that the plaintiff in an action is not entitled to recover or to the relief he seeks, non constat that the action of the court or the conduct of the parties in the appointment of the receiver has been irregular, improper, erroneous, or unnecessary."

Another reason why the objections were properly overruled is that the appellant was not a party to the suit. His claim to the hay and oats having been denied, he had no more right to question the report and account of the receiver than any other stranger to the litigation.

It is submitted, therefore, that the order from which this appeal is taken should be affirmed. If, however, the court should review the order denying the petition of appellant by which he asserted a claim to the hay and oats, the following is presented for the consideration of the court.

Appointment of Receiver of Rents, Issues and Profits, Authorized.

This suit was instituted to foreclose a certain mortgage or trust deed. In the bill of complaint it is alleged:

> "That the real estate and property described in said trust deed is insufficient as security for the payment of the said principal sum and interest and the performance of the covenants to be kept and performed by the said H. H. Nelson Sheep Company, as provided in said trust deed or mortgage, and that the said H. H. Nelson Sheep Company and the said H. H. Nelson are each and both insolvent." (Rec., p. 12.)

The prayer to the bill of complaint reads as follows:

> "And your orators further pray that a receiver be appointed according to the course and practice of this court, with the usual powers of receivers in like cases, of all the property described in said mortgage or trust deed, and the income, rents, issues and profits thereof, to hold and dispose of the same as by this Honorable Court may be ordered, and that the said H. H. Nelson Sheep Company be decreed to transfer and deliver possession of said property, and the whole thereof, to the receiver so appointed; and that Your Honors will enjoin the said defendant H. H. Nelson Sheep Company, its solicitors, officers, agents and servants from in any manner disposing of any of the property subject to said mortgage, or any of the income, rents, issues or profits thereof," etc.

The bill of complaint was filed on the 11th day of April, 1904, and on the same day a writ of subpoena was issued, which was served upon the defendants, the H. H. Nelson Sheep Company and H. H. Nelson on the 28th day of April, 1904. On the 14th day of April, 1904, the judge of this court made the following order in said cause:

> "IT IS ORDERED that the defendant H. H. Nelson Sheep Company, its agents, officers and servants, and all other persons, be and they are hereby restrained and enjoined from selling, disposing of, or transferring the possession of any of the property described in the trust deed or mortgage made a part of

the bill of complaint in this suit, and recorded in the office of the county clerk and recorder of Cascade County, Montana, in Book 18 of Mortgages, page 249, until the further order of the court herein; and

"IT IS FURTHER ORDERED that the defendants herein show cause before the above entitled court in Helena, Montana, where said court is held, on the 17th day of May, 1904, at the hour of ten o'clock A. M. or as soon thereafter as a hearing can be had, why a receiver of the property described in said trust deed, and the rents, issues and profits thereof, should not be appointed as prayed for in said bill of complaint in this suit."

This order was served on the defendant H. H. Nelson Sheep Company on April 16th, and on H. H. Nelson on May 3rd, 1904. (Rec. p. 33.) On the 17th day of August, 1904, the said Sheep Company then being in possession of said property, sold the hay and oats to the petitioner in payment of an antecedent and existing indebtedness. At the time of the sale a part of the crop had been cut and a part was still standing. How much had been cut does not appear. (Rec. p. 62.) Such part may have been a few pounds. The receiver was appointed on the 3rd day of September, 1904, and on the next day took possession of said crop, consisting of hay and oats. (Rec. p. 48.)

The appellant claims that by virtue of said sale to him he is entitled as against the receiver to the said hay and oats. The petition presented is in the nature of a complaint in an action of claim and delivery under the statutes of Montana.

The right of the receiver to the property in question is not based upon any provision of the mortgage or trust deed pledging the rents, incomes and profits and providing for the appointment of a receiver in the event of a default in the payment of principal or interest. It is undoubtedly true that the provision of the mortgage or trust deed that

in the event of such default the mortgagee should be entitled to take possession or have a receiver appointed, is against public policy and void.

Teel v. Walker, 111 U. S. 242.
Couper v. Shirley, 75 Fed. Rep. 168.

In the bill of complaint it is alleged that the property described in the mortgage or trust deed is probably of insufficient value to secure the payment of said mortgage indebtedness, and that the defendants, the H. H. Nelson Sheep Company and H. H. Nelson, the parties liable for the payment of such indebtedness, are both insolvent. These allegations, when properly supported by proof, are sufficient to authorize a court of equity to appoint a receiver of the rents, income and profits of the property, irrespective of any provision in the mortgage pledging the same as security for the payment of the mortgage indebtedness, or any provision with reference to the appointment of a receiver. When the conditions mentioned obtain the mortgagee has the equitable right to have the rents, income and profits impounded and held for the payment of any deficiency that may remain after the application of the proceeds of the mortgaged property.

Astor v. Turner, 11 Paig. Chan. 436.

In the case just cited the chancellor said:

"The holder of a mortgage which has become due, and where the proceeds of the mortgaged premises are not, or when they probably will not be, sufficient to pay his debt and costs, and where the mortgagor or other person who is personally liable for the deficiency is insolvent, may apply for a receiver, to secure the rents and profits of the mortgaged premises which have not yet been collected. In this way he may obtain a specific lien upon the rents and profits to pay such deficiency, or the anticipated deficiency, although he can not call upon the owner of the equity of redemption in the mortgaged premises to refund

rents and profits which the latter had collected or received before the mortgagee attempted to get a specific lien upon such rents and profits by the appointment of a receiver."

See also:

Sea Ins. Co. v. Stebbins, 8 Paig. Chan. 565.
Central Trust Co. v. Chattanooga, 94 Fed. Rep. 275, 281.

In the last case cited the court said:

"When the mortgaged property is not of value sufficient to secure the payment of the mortgage debt, or when its sufficiency becomes substantially doubtful, and the mortgagor is insolvent, accruing interest matured and unpaid, like accruing taxes due and unpaid, takes the character of waste as clearly and distinctively as deteriorations by the cutting of timber, suffering dilapidation, etc.,—the leading illustrations from the earliest time in the adjudged cases and with text writers. In such cases courts of equity always have the power to take charge of the property by means of a receiver, and to preserve not only the corpus but the rents and profits for the satisfaction of the debt."

Omaha Hotel Co. v. Kountze, 107 U. S. 378.
Bank of Auburn v. Roberts, 44 N. Y. 192, 203.

In the last case cited the court said:

"A mortgage of land carries with in, in equity, a right to the accruing rents, when there has been a default, and the security is inadequate and the debtor insolvent. The court will appoint a receiver in such a case to hold the rents till the event is ascertained. The mortgage is thus made to operate as an equitable assignment of the rents."

See also:

Am. & Eng. Enc. of Law, Vol. 23, p. 1026, and cases cited in note.

Petitioner Charged with Notice of Pendency and Purpose of Suit.

The appellant in this case is charged with notice of the institution of this suit and of its purpose, by virtue of the doctrine of *lis pendens*. In the case of Dovey's Appeal, 97 Pa. St. 160, the court say:

> "It (*lis pendens*) affects a purchaser, not because it amounts to notice, but because the law does not allow litigant parties to give to others, pending the litigation, rights to the property in dispute, so as to prejudice the other party. * * * This is a rule of public policy, and the object of it is to prevent the parties from making a conveyance *pendente lite* of the property or thing which is the subject matter of the controversy, and thus to defeat the execution of the decree of the court. The effect of it is to impose a disability to convey from the time of the service of the subpoena upon the defendants. The court, in the execution of its decree, pays no regard even to a bona fide purchaser. In other words, no change of ownership during a suit will prevent the execution of a decree, as it would have been executed had there been no change."

In the case of Leitch v. Wells, 48 N. Y. 585, 608, the court says:

> "It is a rule in equity, long established and acted on, that a purchase made of property actually in litigation *pendente lite*, although for a valuable consideration and without any express or implied notice, affects the purchaser in the same manner as if he had such notice, and he will accordingly be bound by the judgment or decree in the suit. This rule is said to rest upon the presumption that every man is attentive to what passes in the courts of justice of the state or sovereignty where he resides, and to be founded upon public policy; for otherwise alienations and transfers of title made during the pendency of a suit might defeat its whole purpose, and there would be no end to litigation."

See also:

Union Trust Co. v. Navigation Co. 130 U. S. 565.
Murray v. Ballou. 1 John Chan. 566.
Pomeroy Eq. Jur., 3rd. Ed., Vol. 2, Sec. 632, et seq.
Story's Eq. Jur., Secs. 405-6.
Am. & Eng. Enc. of Law, 2nd Ed., Vol. 21, p. 604.
Extended note, 56 Am. St. Rep. 853.

The purpose of the bill of complaint was not only to secure the application of the proceeds of the sale of the mortgaged property to the payment of the mortgaged indebtedness, but also to enforce the equitable right or lien against the rents, issues and profits which existed, by reason of the insufficiency of the security and the insolvency of the parties liable for the payment of the mortgaged indebtedness. The appellant is conclusively presumed to have had knowledge of the fact that the object of the suit was to secure the benefit of the equitable lien or right mentioned at the time he made his alleged purchase.

Furthermore, the agreed statement of facts discloses that appellant "had actual notice that said suit had been commenced to foreclose said trust deed or mortgage before the purchase by him of the property involved in this controversy." (Rec., p. 61). Although he did not have actual knowledge of the prayer of the bill of complaint, or of the order to show cause, his knowledge of the pendency of the suit was sufficient to put him upon inquiry, and he should be treated as having notice of the application for the appointment of a receiver.

Section 4667 of the Civil Code of Montana reads as follows:

> "Every person who has actual notice of circumstances sufficient to put a prudent man upon inquiry as to a particular fact, has constructive notice of the fact itself in all cases in which, by prosecuting such inquiry, he might have learned such facts."

It is also claimed in behalf of appellant that the state statute providing for the filing of notice of the pendency of an action should be regarded as a rule of property and applies to the federal courts. The case of Jones v. Smith, 40 Fed. Rep. 314, is cited in support of this proposition. In the opinion in the case the court said:

> "In the memorandum filed on the former motion it was substantially held that the state statute applied as a rule of property, and that lis pendens in a federal court was not available as notice to innocent purchasers, unless notice thereof is filed, as the statute requires. By filing such notice, therefore, the complainant can effectually prevent the transfer of the property. *Should it turn out, however, that the state statute does not apply, then, under the decisions of the supreme court which were considered on the prior motion, the old harsh doctrine of lis pendens will operate to effect the same result.*" (Italics mine.)

It thus appears that the court did not express a positive opinion, but doubted the correctness of the former holding.

In the case of McClaskey v. Barr, 48 Fed. Rep. 130, decided by Circuit Judge Jackson and District Judge Sage, it was held that the state statute on the subject of lis pendens does not apply to suits in equity in the federal court. The court said:

> "The section referred to is part of the Code of Civil Procedure in the State of Ohio, and does not apply in this court in a suit in equity, nor is it a rule of property in such sense as to make it binding here."

See also:

Rutherglen v. Wolf, Fed. Case, No. 12175.

It is further contended in behalf of appellant that the doctrine of lis pendens does not apply to personal property. In the case of Town of Enfield v. Jordon, 119 U. S. 680, Mr. Justice Bradley, who delivered the opinion, said:

"Rights to real property and personal chattels within the jurisdiction of the court, and subject to its power, may be affected by lis pendens, but not those acquired by the transfer of negotiable securities or by the sale of articles in market overt in the usual course of trade."

See also:

Am. and Eng. Enc. of Law, Vol. 21, p. 626, et seq.

As growing crops, or crops which have matured but which have not been severed from the soil, are not the subject of sale in market overt in the usual course of trade, or are not articles of commerce, the doctrine of lis pendens clearly applies thereto. It is only such personal property as horses, cattle, grain, etc., which are moveable and subject to manual delivery, that are exempt from the doctrine. There is no more reason why the doctrine of lis pendens should not apply to crops which have not been harvested than there is why it should not apply to the land itself.

Application for Appointment of Receiver Prevented Sale of Hay and Oats.

It is held that actual seizure of property is not necessary to the jurisdiction of the court in a case where the possession of the property is necessary to the relief sought. The filing of the bill, it is said, operates as an equitable levy upon the property. In view of these considerations, where a suit is instituted in a federal court, one of the objects of which is the appointment of a receiver, the jurisdiction attaches at the time of the service of the subpoena, so as to prevent a state court from entertaining a later application for the appointment of a receiver over the same property.

Louisville Trust Co. v. Knott, 130 Fed. Rep. 820.
Adams v. Mercantile Trust Co., 66 Fed. Rep. 617.

In the last case cited the court said:

"The possession and control of the railroad were absolutely necessary to the exercise of the jurisdiction of the court. The filing of the bill, and the service of process thereunder was an equitable levy upon the property."

In the case of Memphis Sav. Bank v. Douglas, 115 Fed. Rep. 96, 111, the court said:

"The federal circuit court had acquired full jurisdiction of the bill, which was filed by the plaintiff to enforce and administer the trust, before any of the writs of attachment were levied, and although the receiver, who was subsequently appointed, may not have acquired actual possession of some of the lands before the levies were made, yet within the doctrine last stated the land was not subject to seizure under the writs of attachment, it being, potentially at least, *in custodia legis*."

In the case of Belmont Nail Co. v. Columbia Iron and Steel Co., 46 Fed. Rep. 8, it was held that an assignment for the benefit of creditors made by a corporation after service of process on it in a suit by a creditor for the appointment of a receiver, does not deprive the court of jurisdiction to appoint such receiver. In the opinion the court said:

"The right of the complainant, upon the insolvency of the defendant company, to file its bill for the benefit of itself and such other creditors as might join, for the purpose of obtaining the aid of the court sitting in equity, to apply the assets of the corporation to the payment of its debts, being unquestioned, it necessarily follows that, upon the service of the subpoena upon the defendant company, the jurisdiction of this court was complete, both as to the parties and the subject matter. This as the record shows, was on the 26th day of March, 1891. Hence the relation of the parties and the status of the property in question must be considered as of that date. No subsequent action of one of the parties could affect the rights of the other party. Any disposition by the defendant company of its assets (except the sale of

personal property or transfer of negotiable securities to bona fide purchasers) would be invalid, as against the rights of the other party."

See also:

Gaynor v. Blewett, 33 Am. St. Rep. 47.
Jackson v. Losee, 4 Sandf. Chan. 381.

By virtue of the allegations in the bill of the insufficiency of the security and the insolvency of the parties liable for the payment of the indebtedness, and the application for the appointment of a receiver, a specific lien was acquired upon the rents, issues and profits of the real estate.

Astor v. Turner, 11 Pag. Chan. 436.

The lien thus created is analagous to the lien created by the filing of a creditor's bill and the service of process.

King v. Goodwin, 130 Ill. 102; 17 Am. St. Rep. 277. Extended note to 90 Am. Dec. 295, where many cases are cited in support of the proposition stated in the following language:

"In general, where no specific lien has been acquired upon the property before suit, the filing of a creditor's bill in equity to reach personal assets of the debtor will operate as a specific lien in the nature of an attachment or equitable levy upon the properties sought to be charged, and will confer priority of right to payment out of the proceeds as against other creditors or purchasers pendente lite."

In the case of Farmers' Loan & Trust Co. v. Detroit Co., 71 Fed. Rep. 29, it was held that after the institution of a suit to foreclose a mortgage covering all the property and net earnings of a railroad company, no lien on such earnings can be acquired by a general creditor. In the opinion the court said:

"But, if the fund here in controversy was liable to the seizure at the instance of creditors, no step was taken by petitioner before this suit was commenced to arrest it in the hands of the mortgagor or its agent."

In the opinion the court also said:

> "By the institution of the foreclosure suit in this court on the 4th of September, 1893, this court acquired jurisdiction of the property, and took possession thereof for the purpose of administering the same, and enforcing the remedies of the complainant and other lien creditors, and thereby exempted the property from the process of any other tribunal. Having then no lien upon this fund, petitioner could acquire none upon it, or on any part of the mortgaged property, *after the institution of this suit.*"

In the case of Freedman's Savings & Trust Co. v. Shepherd, 127 U. S. 494, the court said:

> "It is, of course, competent for the parties to provide in the mortgage for the payment of the rents and profits to the mortgagee, even while the mortgagor remains in possession. But when the mortgage contains no such provision, and even where the income is expressly pledged as security for the mortgage debt, with the right in the mortgagee to take possession upon failure of the mortgagor to perform the conditions of the mortgage, the general rule is that the mortgagee is not entitled to the rents and profits of the mortgaged premises until he actually takes possession, or until possession is taken in his behalf by a receiver, *or until in proper form he demands and is refused possession.*" (Italics mine.)

In the case of Dow v. Memphis & Little Rock R. Co., 124 U. S. 652, it is held that the institution of a suit to foreclose and for the appointment of a receiver is such a demand of possession as will entitle the mortgagee to the rents, income and profits from the time of the institution of the suit, although the receiver is not appointed until some time subsequently. In the opinion the court said:

> "It follows that from the time of the bringing of the suit the company itself is to be treated in all respects as a receiver of the property, holding for the benefit of whomsoever in the end it should b found to concern and liable to account accordingly."

See also:

Barron v. Whiteside, 43 Atl. 825.

It appears from the agreed statement of facts that the suit was instituted and the application made for the appointment of a receiver about the middle of April. This was before the grain was planted. As the right of the mortgagee must be determined by the conditions existing when the application for the appointment of the receiver was made the question really presented is whether or not a crop sown and grown after such application is made can be taken.

The Appellant Was an Intermeddler with Property in Litigation, and Is Bound by the Result of Such Litigation.

In the case of Tilton v. Cofield, 93 U. S. 163, the supreme court say:

> "The law is that he who intermeddles with property in litigation does it at his peril, and is as conclusively bound by the results of the litigation, whatever they may be, as if he had been a party to it from the outset."

In the case of Mellen v. Iron Works 131 U. S. 352, the court say:

> "Purchasers of property involved in a pending suit may be admitted as parties, in the discretion of the court; but they can not demand, as of absolute right, to be made parties, nor can they complain if they are compelled to abide by whatever decree the court may render within the limits of its power, in respect to the interest their vendor had in the property purchased by them *pendente lite*. As said in Bishop of Winchester v. Paine (11 Ves. 194, 197), 'the litigating parties are exempted from the necessity of taking any notice of a title so acquired. As to them it is as if no such title existed.'"

Right to Have Receiver of Rents, Issues and Profits, Appointed Not Controlled by State Law.

The right to have the rents, issues and profits of real estate embraced in a mortgage preserved for the payment of any deficiency judgment is one existing by virtue of the general principles of equity jurisprudence. The jurisdiction and power of this court as a court of equity to preserve rents, issues and profits pending the determination of the question of whether or not the property mortgaged is sufficient security and the debtor insolvent, can not in any manner or to any extent be controlled by any state statute. In the case of Ex parte Tyler, 149 U. S. 164, the court said, in speaking of a state statute which prohibited the issuing of an injunction to prevent the collection of illegal taxes:

> "Manifestly the object of this legislation was to confine the remedy of the taxpayer for illegal assessment and taxation, to the payment of taxes under protest and bringing suit against the county treasurer for recovery back. But all this is nothing to the purpose. The legislature of a state can not determine the jurisdiction of the courts of United States, and the action of such courts in according a remedy denied to the courts of a state does not involve a question of power."

Right of Mortgagee to Rents and Profits Conferred by Mortgage.

It is provided in the mortgage that upon the failure of the mortgagor to comply with the conditions thereof "all rents and profits of said property shall then accrue to the benefit of the mortgagee." This provision is valid.

O'Hara v. Mobile & O. R. Co., 75 Fed. Rep. 130, 133.

* * * * * *

In the brief for appellant, at page 24, it is said:

> "If the court below be correct in its ruling against appellant to the effect that the mortgage was a lien upon the crops," etc.

The record does not disclose that the court so held. It is not claimed by appellees that the mortgage created a lien upon the crops. The contentions of appellees are fully stated, and it will be presumed that the court, in denying the petition, did so in the light of the admitted facts and the law applicable thereto, to which attention has been directed.

The circuit court did not commit error in denying the petition.

Respectfully submitted,

M. S. GUNN,

Attorney for Appellees.